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Financial Markets

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research & Planning Division

Friday (Noon)

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Securities markets took on a decidedly optimistic tone early this week, when a $2.8 billion drop in M-1B was reported for the week ending December 24, extending the recent slowdown in money growth. By mid-week, however, the early rate declines had been reversed, reflecting a Federal funds rate that seemed stuck in the 19%-20% range.

The high overnight rates put substantial pressure on securities dealers who had taken positions earlier in the week in anticipation of further rate declines. A graphic illustration of the financing squeeze occurred on Tuesday, when the Federal Reserve offered $1.5 billion of overnight repurchase agreements for the account of a customer. The entire amount was taken by the bid of one firm at a very high rate--a quite unusual event.

What convinced many market participants that the high funds rate was not a temporary aberration was the Fed's execution of overnight reverse repurchase agreements (which drain reserves) on Wednesday. Many concluded that the Fed did not intend to allow the funds rate to decline, perhaps due to skepticism as to how permanent the recent slowdown in money growth might be. There is no doubt, of course, that the Fed has a healthy skepticism with regard to weekly money data and might reasonably want to see more evidence of a trend before undertaking a major change in its policy stance. But that does not mean that it intends to peg the funds rate in the 19%-20% area, as some seem to believe.

As always, it is important to have perspective. During the statement week ended Wednesday, the reserves market was under pressure for several essentially technical reasons--foremost among them the decline in Federal Reserve float from its near-record level of the week before. Such a drop reduces bank reserves, and the Fed undertook to offset the shortage, but the situation nevertheless imparted some aggressiveness to banks bidding for funds. That contributed to upward pressure on the funds rate. This situation--in reduced degree--is likely to continue for the next week or so (absent some major, unpredictable swing in float).

But after that, the reserves environment will become increasingly favorable to a downward drift in the funds rate. Seasonal inflows of currency from the public to the banks will tend to create a reserve excess, thus--other things being equal --reducing banks' aggressiveness in bidding for funds. Also, few banks are now subject to the 3% supplement to the Fed's 13% discount rate, making their cost of funds from that source much lower than in December. Last--but definitely not least--we expect that the lagged effects of the recent punitively high interest rates will continue to produce relatively sluggish money growth--though nothing like the contraction in the second quarter of 1980.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

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Market Yields

	1/9/81 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	20.00%	20.50%	15.25%
Effective since	1/9/81		
Discount Rate at Federal Reserve Bank	13.00	13.00	12.00
Federal Funds	19.50	20.00	14.07
Repurchase Agreements	19.25	18.50	12.50
U.S. Treasury Issues			
Bills			
3 months	15.85	15.45	12.15
6 months	15.43	15.10	12.55
1 year	14.01	13.98	11.80
Coupons			
2 years	13.30	13.12	11.27
4 years	13.00	12.75	10.62
7 years	12.64	12.52	10.59
10 years	12.35	12.46	10.61
Long Bond	12.02	12.01	10.31
Negotiable Certificates of Deposit-Secondary Market			
1 month	18.25	17.60	13.30
3 months	17.65	17.25	13.35
6 months	16.20	16.00	13.37
1 year	14.75	14.50	13.55
Banker's Acceptances			
1 month	18.25	17.25	13.15
3 months	17.90	16.25	13.35
6 months	16.25	14.50	13.40
Eurodollar Deposits			
1 month	18.88	19.38	14.00
2 months	18.50	18.50	14.13
3 months	18.13	18.00	14.19
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	17.00	16.00	12.25
1 month	16.25	16.75	12.75
3 months	15.00	15.00	12.00
Bank Holding Companies			
1 month	17.63	17.75	13.00
Dealer Placed:			
3 months	17.00	16.50	13.00
New AA Corporate Utility Bond	14.50	14.38	11.88
Tax Exempt			
6 month Project Notes	7.25	7.75	5.75
1 year AAA Bond	6.75	7.25	NA
5 year AAA Bond	7.00	7.50	NA
20 year AAA Bond	8.25	8.75	6.70

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

Cable Address:
"IrvingBank" Telex: I.T.T. 420268 • R.C.A. 232241
W.U.I. 62832 • French 82629